## TAPR IQC Egypt Technical Assistance to Support Economic Policy Reform

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## DSP I Monitoring & Verification Report #3





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## **Submitted by:**

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#### I. INTRODUCTION AND BACKGROUND

The Development Support Program I (DSP I) is a policy reform program designed to assist the Government of Egypt in achieving its planned reform measures. The specific policy measures supported under this program are termed "Indicators" in the Monitoring Plan agreed to between the Government as represented by the Ministry of International Cooperation (MIC) and USAID. They are the performance measures that are the means of achieving the Specific Objectives in the Memorandum of Understanding and are the basis for disbursement of USAID funds.

In 1999, the MIC and USAID agreed on six DSP I Specific Objectives, under which 23 Indicators were identified. Each Indicator was assigned a dollar value, which originally totaled \$600 million for all of DSP I. Subsequently the Government and USAID entered into discussions regarding the addition of several new policy reform initiatives to the original list of indicators. Those new indicators that have been agreed to total \$100 million.

The total of the first and second disbursements was \$119.3 million.

The purpose of this report is to present information on the measurement of progress through August 20, 2001, as it relates to the projected third disbursement and to discuss problems and issues encountered and prospects for the future. This report should be read as a continuation of the first two Monitoring and Verification Reports and is in relation to the amended DSP I Monitoring Plan.

#### II. STATUS OF DSP I INDICATORS

**INDICATOR 1.a:** The GOE achieves progress in implementing its Law 203 companies' privatization plan. (Maximum possible disbursement is \$95 million.)

#### **Background**

As of the beginning of DSP I (March 31, 1999), 105 of the 314 Law 203 affiliated companies (ACs) had been privatized. Of these 105, 31 were privatized through public offerings and 17 were privatized through anchor investor sales.

As agreed to in the Monitoring Plan, \$95 million will be disbursed under DSP I when 80 of the remaining 209 ACs are privatized. Pro rata disbursement is permitted.

## **Progress to Date**

From the beginning of DSP I on March 31,1999, through the second DSP I Monitoring Report, 23 companies were privatized by the MPE and \$27.4 million was disbursed under DSP I for this benchmark. Since then, an additional 4 companies have been privatized and several others are in final process: There were 3 liquidations (Arabia for Carpets, Segal, and Shaher and Romney) and 1 ESA (Gharbia husk mill). Another Anchor investor sale (National for Metal Industries) and two ESAs and one IPO are under review by the Ministerial Privatization Committee and have not yet been approved.

**INDICATOR 1.b:** The GOE divests its shares in the joint venture (JV) firms. (Maximum possible disbursement is \$30 million.)

#### Background

In the original DSP I Monitoring Plan, disbursements towards the Joint Venture target were to be based on the book value of the firms that were to be divested. The difficulty with this has turned out to be that reliable information on the book value of JV firms is not generally available. In addition significant revisions in the approach to privatization of Joint Ventures are under discussion.

#### **Progress to Date**

An inventory of all the joint ventures was completed. The firms proposed for divestiture during DSP I are currently being decided upon by the Government.

#### **Prospects and Issues**

The Government and USAID are discussing the criteria to be used for a revised monitoring and verification procedure for this indicator. Joint Ventures divested by the public sector since April 1, 1999, (the beginning of DSP I) that meet the new criteria will be counted toward this indicator.

**INDICATOR 1.c:** The GOE authorizes BOOT or BOT contracts, which are successfully let. (Maximum disbursement is \$15.0 million.)

#### **Background**

To date, several BOOT and BOT projects have been awarded. In the power sector, the first BOOT contract was awarded to build two gas and oil-fired steam facilities in Sidi Kreir. In February 1999, a BOT contract was signed with the French to construct \$1.2 billion worth of electrical power generation plants in North West Gulf of Suez and East Port Said. In the transportation sector, several regional airports are under construction or development using BOOT contracts. In the water & wastewater area, the first major private, water scheme was developed in the 10<sup>th</sup> of Ramadan City. A BOT contract was signed in August 1998 for building and operating containers stations in Shark El Tafri'aa.

Under the Monitoring Plan, \$15 million will be disbursed under DSP I on a pro rata basis as the goal of LE 6 billion in contracts signed is achieved.

#### **Progress to Date**

Three BOOT/BOT contracts were signed in 1999 for the container terminals at Port Said and Ein El Sokhna and the El Dekheila Port. The second DSP I disbursement included \$2.8 million for this progress. More recently the conditionalities for contract effectiveness in the airport contracts for Farafra and Bahariya airports which were signed on September 20, 1999 are informally reported to have been satisfied. The formal documentation for these transactions should be completed prior to the end of DSP I.

**INDICATOR 1.d:** The GOE continues to lease firms/units to the private sector on a long-term basis with an option to buy. (Maximum disbursement under this indicator is \$15.0 million.)

#### **Background**

Under DSP I, leases with an option to buy will generate disbursements on a pro rata basis up to \$15 million when LE 6 billion in leases are signed.

#### **Progress to Date**

Between March 31,1999, and the second DSP disbursement one lease contract was signed with an option to buy. Although additional leases have been entered into since the second disbursement and some of them provide a right of first refusal, if it is decided to sell the company, none of these new leases have options to buy as such.

**INDICATOR 1.e:** The GOE sells its shares in electricity and telecommunication companies to the private sector. (Maximum disbursement under this indicator is \$15 million.)

#### Background

As agreed to in the DSP I Monitoring Plan, up to \$15 million may be disbursed on a pro rata basis when the government sells LE 1.5 billion in shares in electricity and/or telecommunication companies, provided that each IPO is for a minimum of 10% of the shares of the company.

#### **Progress to date**

The valuation of the assets of Egypt Telecom has been completed. A draft telecommunications law has been prepared that will organize operations of the sector and set guidelines for the relationships between the Government, the private sector, and service subscribers.

For electric power, the government has transformed the Egyptian Electricity Authority (EEA) into a holding company. The holding company owns the seven regional power generation and distribution companies. The government plans to separate the generating facilities from the distribution companies and privatize the latter. A Presidential Decree has been issued establishing a power regulatory authority – a key step in proceeding with the privatization program.

#### **Prospects and Issues**

Although the groundwork has been laid for the sale of shares in Egypt Telcom, the Government has postponed the planned sale until the international market strengthens.

Prior to the sale of shares in the electric power companies, the identified financial and policy issues including the debt burden of the electric companies must be addressed as well as any issues regarding regulatory responsibilities and authorities such as those relating to the setting

of tariffs. Based on available information, steady progress is being made toward private participation in the electric sector. The DSP I time frame may be too short to be appropriate for completing all of the necessary actions required before carrying out the initial sale of shares of the electric companies.

Because of the above issues regarding the sale of shares in these industries, this objective may more appropriately be considered for inclusion in DSP II.

**INDICATOR 1.f:** The GOE performs valuations for the four public sector insurance companies. (Maximum disbursement under this indicator is \$ 10 million.)

#### Background

To complement other privatization efforts, the GOE plans to restructure the second key component of the financial sector, the insurance sector. Through the enactment of Law 156/1998, the GOE set out to privatize the insurance sector.

#### **Progress to Date**

The first stage in the privatization of the four state-owned insurance companies was completed with the valuation of the four insurance companies by the consulting companies, Flemming and Morgan Stanley. With the completion of the valuation of the insurance companies and the acceptance of this valuation by the Government, this Indicator has been accomplished.

**INDICATOR 1.g:** The GOE achieves progress in implementing its plan to privatize the public sector insurance companies. (Maximum disbursement is \$15 million.)

#### **Prospects and Issues**

The time required for the privatization of the insurance firms now that they have been valued means that Indicator 1.g may appropriately be included in DSP II.

**INDICATOR 1.h:** The GOE achieves progress in implementing its plan to privatize the public sector banks. (Maximum disbursement under this indicator is \$15 million.)

#### **Background**

In June 1998 the GOE issued Law 155/1998, which allowed for the privatization of state banks. The privatization of the four state banks will give a boost to the financial sector and ultimately the Egyptian privatization process.

#### **Prospects and Issues**

Government spokesmen have indicated that the government does not plan to proceed with the privatization of these banks at this time. At present there is a significant amount of debt and equity in SOEs and JVs held by these banks. Until the consolidation of debt/equity positions

among the SOEs, JVs, banks and government can be rationalized and any issues of non-performing loans can be addressed, it will be difficult to proceed with bank privatization.

**INDICATOR 1.i:** The GOE agrees to use the privatization proceeds primarily for: debt retirement/financial restructuring of public enterprises to be privatized; employee compensation relating to downsizing/liquidation; costs of selling public enterprises; and reduction of domestic public debt. (Maximum disbursement is \$5 million each fiscal year.)

#### **Background**

In August 1998, the Ministerial Committee on Privatization (MCP) restricted the use of privatization proceeds to funds transferred to the MOF, early retirement payments and settlement of public enterprises debts. Funds transferred to the MOF represented an additional revenue to the general budget and hence contributed to the reduction in the budget deficit. Prior to November 1999, the government directed two-thirds of the sales proceeds to the MOF and one-third was retained by the holding companies. In November 1999, the Prime Minister issued a decree establishing a special fund to support the privatization program that would receive 50% of sales proceeds. The remaining 50% go to the MOF. Having a central fund is an improvement over having the privatization funds generated remain with the responsible holding company. A central fund permits allocations to the firms that can make best use of them.

#### **Progress to Date**

Uses of the sales proceeds through FY 2000 were in keeping with the DSP I Monitoring Plan and \$5 million for this indicator was included in the second disbursement. Use of sales proceeds during FY 2001 were as follows:

	Cumulative	Cumulative	Proceeds/Uses
	<b>30 June, 2000</b>	30 June, 2001	in 2001
<b>Cumulative Proceeds</b> (LE Millions)	12,980	13,853	873
Uses	11,331	13,585	2,254
Debt Settlement	3,601	4,303	702
Early Retirement & Wages	1,908	2,521	613
Transfer to MOF	5,822	6,322	500
Technical and Management Reform	0	439	439
<b>Use of Balance in Proceeds Fund</b>			1,381

These uses were also in keeping with the DSP I Agreement.

**INDICATOR 2:** The GOE enacts a new labor law. (Maximum disbursement under this indicator is \$70 million.)

#### **Background**

Labor Law 137/1981 governs employer/employee relationship. Formal discussion of a new labor law began in October 1991, with the establishment of a committee consisting of

representatives from the Egyptian Trade Union Federation (ETUF), business organizations, the Ministry of Labor, the local legal community, and the International Labor Organization (ILO).

After prolonged negotiations among unions, business associations, and the government, the Egyptian government drafted a law to dramatically diminish the state's role in labor affairs. President Mubarak, in his 1999 Labor Day speech, called for speeding the passage of the new labor law. The draft law was actively debated because it represented such a sharp departure from previous Egyptian social/economic philosophy. It signified a formal withdrawal from the Nasserist "moral economy," in which Egyptians came to expect the state to guarantee job security and a living wage in exchange for their contribution to national production.

To be in keeping with the DSP I agreement, the new law should include at least the following:

- Give both private employers and public sector managers greater leeway to hire and fire.
- Free labor unions from GOE control so that they can champion worker rights in a free market setting.
- Allow private sector employers to use temporary contracts.

Under the terms of the DSP agreement, \$70 million can be disbursed on a pro rata basis as a new law moves to enactment by the Peoples Assembly. As is the case with the passage of other laws included in DSP I, 60% can be disbursed when the Cabinet approves the law, and 40% when the law is enacted by the Peoples Assembly.

#### **Prospects and Issues**

Following a renewed call for the enactment of a new labor law by President Mubarak in the spring of 2001, a revised draft law was approved by the Cabinet and submitted to the Peoples Assembly. The draft law is in keeping with the DSP I Monitoring Plan. The responsible committee in the PA is currently reviewing the law.

**INDICATOR 3.a:** Egypt becomes a member of the Patent Cooperation Treaty. (Maximum disbursement is \$10 million.)

#### Background

The Patent Cooperation Treaty (PCT) is an international agreement that provides an alternative procedure for obtaining patent protection in foreign countries. The PCT permits an applicant to apply for patents in member countries by filing a single "international application" in the applicant's own country and designating the countries in which patent protection is desired. Signing the PCT agreement will render several positive effects on the Egyptian market, more specifically it will increase the effective patent term.

Under the terms of the DSP I agreement, up to \$10 million can be disbursed in support of this indicator.

#### **Prospects and Issues**

It is anticipated that the Patent Cooperation Treaty will be enacted after the Peoples Assembly passes the IPR law recently approved by the Cabinet and currently being considered by the PA.

**INDICATOR 3.b**: The GOE amends the Trademark Law. (Maximum disbursement under this indicator is \$20 million.)

#### **Background**

The Egyptian Trademark Law was first enacted in 1939. Egypt is seeking to change its trademark law to conform to the TRIPS Agreement (TRIPS is an annex to the Agreement establishing the WTO). Uniformity in the trademark law and practice will enhance trade relations with other countries.

#### **Progress to Date**

The GOE has combined all IPR laws currently under development into one law. This law includes a section that addresses some of the concerns regarding trademarks that were included in the DSP Monitoring Plan. The Cabinet has formally approved the draft law and the Peoples Assembly approved it in principle. There are, however, several additional issues that need to be addressed before Egypt's draft IPR Law will be WTO TRIPS compliant.

#### **Prospects and Issues**

Following enactment the law will be reviewed for compliance with the WTO Agreement.

**INDICATOR 3.c:** The GOE enacts a new Industrial Design Law. (Maximum disbursement is \$15 million.)

#### **Background**

An industrial design law promotes economic development by protecting decorative aspects of useful objects. By encouraging innovation in this area, manufacturers can offer pleasing and distinctive versions of common items.

#### **Progress to Date**

The GOE has combined all IPR laws currently under consideration into one law. There are several elements in the draft law that was approved by the Cabinet that were not compliant with WTO understandings, but several revisions were introduced during the Peoples Assembly review.

#### **Prospects and Issues**

Following enactment the law will be reviewed for compliance with the WTO Agreement.

**INDICATOR 3.d:** The GOE reduces tariff rates and/or fees on imports. (Maximum disbursement under this indicator is \$65 million.)

#### **Background**

One of the major components of the trade liberalization policy begun by the GOE in 1991 was the reduction in tariff rates and import fees. The GOE actions to reduce tariff rates lowered the effective rate of protection (ERP) across the sub-sectors of the economy. The simple average ERP fell from 43.5% in 1994 to 32.9% in 1996 and to 31% in 1997. Similarly, the trade weighted average was reduced from 18.8% in 1995/96 to 17.9% in 1997/98. However, in 1998/99 the trade weighted average tariff increased to 20.2 %. The ERP for many individual commodities remains very high because of the acceleration of tariff rates between unfinished and final products. This high level of protection is a factor in the relatively low level of international competitiveness of Egyptian industry and contributes to the low growth in Egyptian exports.

#### **Progress to Date**

The Tariff Department of the Customs Authority reported no net reductions in tariff since March 31, 1999.

### **Prospects and Issues**

Although there are concerns within the government regarding the possible negative impact on government revenues in the short term that could result from additional tariff reductions, further tariff reductions are under consideration

**INDICATOR 3.e:** The GOE adopts a new method of customs valuation. (Maximum disbursement under this indicator is \$20 million.)

#### **Background**

Egypt ratified its membership in the WTO in 1995 and became obligated to adopt the GATT/WTO Customs Valuation Agreement by June 30, 2000. The WTO extended the deadline for compliance until June 30, 2001. The process of applying the new valuation methods has started.

#### **Progress to Date**

Because of the importance of the customs valuation issue, the sections of a new customs law being developed by the Government that pertain to import valuation were submitted separately to the Peoples Assembly and were enacted as amendments to the existing Customs Law. The new amendments establish the price paid or payable as the basis for customs valuation. However, the articles on valuation were very summary in nature and, for implementation to be effective, the drafting of the executive regulations and the development of operating procedures are particularly important.

The executive regulations for the new law have been drafted and issued by the Ministry of Finance. The revised operating procedures for the Customs Service have also been drafted.

#### **Prospects and Issues**

The executive regulations have been reviewed in relationship to WTO requirements. On the basis of this review most of the regulations are considered to be broadly consistent with the WTO Agreement, although several elements are not. The Ministry of Finance and the Customs Service are currently reviewing those modifications that appear to be necessary to achieve compliance with the WTO agreement.

**INDICATOR 3.f:** The GOE issues a decree protecting undisclosed information and data exclusivity for pharmaceutical products. (Maximum disbursement is \$10 million.)

#### **Background**

Under the WTO TRIPS Agreement, Egypt was to have in place by January 1, 2000, the data protection provisions outlined in TRIPS Article 39.3, relating to the protection of test and other data submitted for marketing approval of pharmaceutical products.

#### **Progress to Date**

The MOEFT has issued a decree that appropriately addresses data exclusivity objectives. However, the Government has included data exclusivity in the new IPR Law currently being considered by the Peoples Assembly. Upon enactment, the new law will be reviewed for its consistency with WTO undertakings.

**INDICATOR 3.g** The GOE establishes a system that simplifies import inspection and sampling procedures as an important step toward compliance with WTO TBT and SPS agreements. (A maximum disbursement of \$20 million is possible)

#### **Background**

In the past, several ministries in several different locations carried out import inspection procedures. Testing was done purely for quality aspects as well as for health and safety, tests were often slow, criteria frequently changed, and some of these procedures represented a considerable obstacle to trade.

As an important step toward dealing with these issues, President Mubarak issued Decree 106 on 2 Feb 2000 "Concerning Facilitation of Inspection and Control Procedures for Exports and Imports." This decree directs personnel from the various inspection agencies to be detailed to GOEIC's branch offices "where a joint headquarters shall be equipped with the necessary laboratories." It indicates that these personnel will be under the administrative supervision of GOEIC and shall be authorized to assume inspection and certification functions without referral to higher authority.

#### **Progress to Date**

The GOE took an important step toward implementing Decree 106 with the issuance of Decrees 346 and 524 that provide the executive regulations that simplify import inspection and sampling procedures. These decrees specify sampling quantities, time allowed for testing, and procedures for handling the samples. On the basis of these decrees an initial disbursement of \$10 million was included in the second disbursement. Discussions with importers indicate that the decrees are being implemented and have simplified the import process considerably. The successful implementation of these decrees satisfies the remainder of this benchmark.

**INDICATOR 4.a&b:** Full disbursement will be possible if the budget deficit is less than 1.4% of GDP in FY 1999 and FY 2000. No disbursement will occur if the deficit is greater than 2.0% of GDP. (Maximum disbursement under this indicator is \$25 million for each of the two fiscal years.)

## Background

The budget deficits in FY 1999 and 2000 exceeded the amounts anticipated in the DSP I Monitoring Plan.

**INDICATOR 5.a:** The MOE drafts, approves and begins to implement a plan for reforming the insurance industry. (Maximum disbursement for this indicator is \$20 million.)

## **Background**

The GOE issued Law 156 in June 1998 to amend the insurance laws 10/1981 and 91/1995 and allow for the privatization of public sector insurance companies and the operation of foreign insurers in the domestic market. Reforming insurance regulation is a must to ensure fair competition among all insurance market players.

Prior to the beginning of DSP I, the GOE took positive steps towards a liberalized insurance market, such as tariff deregulation for most classes of insurance activities, privatization of most joint venture insurance companies, and allowance for foreign competition in the market. However, some of the insurance rules and regulations also need to be amended and others need to be created and implemented. For instance, regulations governing brokers should tighten their licensing requirements and allow for the operation of foreign brokers. Similarly, regulations governing private insurance funds should be amended to allow for closer supervision of those funds. Tariffs of all classes of insurance activities should be deregulated and taxes on insurance should be reduced or eliminated in order to facilitate the sale of insurance. More transparency and disclosure are needed among market players, and better trade practices should be ensured and closely monitored by EISA to protect consumers. Under the terms of the DSP I agreement, the maximum disbursement for this indicator is \$20 million. Pro rata disbursement is possible when a plan is drafted by EISA that addresses certain key issues, the MOE adopts the plan, and at least one item in the reform plan is implemented.

Several issues were agreed to in the DSP I monitoring plan as examples of what might be included in the reform plan. The following four were considered as minimum components of an effective reform plan.

- 1- monitoring trade practices, advertising and sales materials by EISA;
- 2- effective dispute resolution between insurance companies;
- 3- allowing both local and foreign insurance and reinsurance brokers to equally participate in the market:
- 4- Effective regulation of private pension funds.

#### **Progress to Date**

EISA completed the draft reform plan for the insurance industry and the MOEFT approved it in September 2000. The plan contains the above four key elements as well as many others that are important for the development of the insurance industry in Egypt. A \$12 million disbursement was included in the second disbursement on the basis of the progress made. The next step was the implementation of one of the above elements of the plan. The MOEFT has issued a decree that implements the element of the plan concerned with the regulation of trade practices, advertising and sales material. This completes the achievement of this benchmark.

**INDICATOR 5.b:** The GOE reduces the percentage of re-insurance that must be placed with Egypt-Re. (Maximum disbursement against this indicator is \$20 million.)

#### **Background:**

The private insurance sector in Egypt comprises twelve insurance companies: four state companies, six private sector companies, and two free zone companies (operating exclusively in the free zones). Egypt-Re, which is a state company, is the only local re-insurer. Since all insurance companies use re-insurance to spread the risks and to avoid over-concentration in certain types of insurance, re-insurance is a vital sub-sector in the insurance market.

According to the insurance Law No. 10 of 1981, insurance companies working in the Egyptian insurance market are required to reinsure part of their insurance transactions carried out in Egypt with Egypt-Re. Each insurance company was required to purchase reinsurance from Egypt Re. The compulsory cessions to Egypt Re imposed a burden on insurance companies since it increased the retention they have to keep and affected their investment portfolios. It also discouraged foreign reinsurance companies from participating in the Egyptian insurance market.

In recognition of this, in early 1999 a decree was issued that established a plan for reducing these mandatory levels of reinsurance at Egypt Re. Under DSP I, \$10 million can be disbursed in both 2000 and 2001 when the reinsurance requirements are reduced as specified in this plan.

#### **Progress to Date**

The percentage of reinsurance that must be placed with Egypt Re is being reduced as specified in the decree, which is as described in the DSP I Monitoring Plan. An initial disbursement of \$10 million was included in the first disbursement for meeting the objectives of this indicator for 2000. The government has continued to effect annual reductions in accordance with the Decree and in keeping with the DSP I Monitoring Plan.

**INDICATOR 5.c** The GOE amends the Capital Market Law. (The maximum disbursement under this indicator is \$20 million.)

#### **Background**

In 1992, the GOE issued the Capital Market Law 95 (CML) to revitalize the Egyptian securities markets. The law empowers the Capital Market Authority (CMA) to act as the regulator of the market. The CML provided the framework for the establishment of capital market intermediaries including: brokerage firms, mutual funds, mutual fund management companies, portfolio managers, underwriting institutions and venture capital firms. Provisions within the law also facilitate the issuing of corporate bonds. Furthermore, the law allowed foreign ownership of Egyptian securities.

However, there are some issues that need further legislative actions. The Ministry of Economy, in cooperation with the CMA, is currently working on drafting a new Capital Market law. The Ministry of Economy contracted with a U.S. legal firm to assist in drafting the new law. The Capital Market Development Project is providing technical expertise for the drafting of the implementing regulations.

Under the terms of the DSP I monitoring plan up to \$20 million can be disbursed against this indicator on a pro rata basis as the law moves toward final enactment by the Peoples Assembly.

#### **Progress to Date**

A draft law was prepared and a draft set of executive regulations were also prepared. These drafts are currently under review within the government. There is general agreement among the involved government ministries on the content and objectives of the law and therefore good prospects that an agreed upon draft will be completed by the end of DSP I.

**INDICATOR 5.d** The GOE enacts a new stock market depository law. (The maximum disbursement against this indicator is \$20 million.)

#### **Progress to Date:**

A new depository law has been enacted that fully meets the objectives of this DSP I indicator. All planned funds were disbursed in the first disbursement.

**INDICATOR 5.e:** The GOE enacts a new law governing mortgages. (The maximum disbursement against this indicator is \$20 million.)

#### Background

In Egypt, the mortgage market is underdeveloped. Only 3% of the total credit and investment portfolios of the banking sector are allocated to real estate. A mortgage market for financing real estate assets is an essential component of the development of an efficient financial sector. Given the importance of real estate's share of all the tangible capital in a country, and the potential for real estate collateral to secure large amounts of debt, the real estate finance system should become an engine of innovation for the rest of the financial sector. On the other hand, if the real estate finance system is underdeveloped, then other non-market devices will develop for financing and subsidizing the real estate sector. These alternatives may be costly, inefficient, and/or risky. Banks are usually reluctant to make mortgage loans because of the risks and high costs associated with mortgage lending (credit, interest rate, and liquidity risk).

To solve this problem, a secondary mortgage market should be developed together with the primary market. Secondary mortgage markets are very important instruments for eliminating the constraints that have slowed the development of real estate finance systems. They can confer two main benefits. First, banks can shed the risks associated with holding mortgage loans by selling the loans to other investors through the secondary market. Second, secondary markets create standards for credit evaluation and collateral procedures that directly increase the efficiency of the primary markets for new mortgage loans.

#### **Progress to Date**

A draft law was prepared in 1999 on which the Government solicited extensive comments from the private sector. Following this process, the Government revised the draft law to reflect the concerns of the private sector. This law was approved by the Cabinet and \$12 million was included in the second disbursement. The Peoples Assembly has now enacted the law. It provides for the basic regulatory structure for a mortgage market and will create a primary and secondary mortgage market. It satisfies the objectives of the DSP I Monitoring Plan and completes the requirements of this benchmark.

**INDICATOR 5.f** The GOE issues regulations required to regulate margin trading. (Maximum disbursement is \$5 million.)

#### Background

Margin trading in equities presently takes place in Egypt but without regulatory oversight. The current practice puts both customers and brokers at risk. It also creates risks to the banking community and to the trading of stocks in general.

Margin trading increases the volume and consequently the liquidity of capital market transactions. It allows investors to more fully participate in the capital markets and by increasing their ability to invest it increases the amount of capital available for private investment. Regulating margin trading will protect the investors; limit the exposure of the

broker/dealers; and define and limit the credit risk to the banking system. That current margin trading practices come under appropriate regulation would be desirable not only for the protection of all the market participants but also for the support of the orderly functioning of the stock market itself.

#### **Progress to Date**

Draft regulations have been prepared by the Capital Market Authority that would regulate margin trading. The Government intends to issue these regulations after the new Capital Market Law is enacted.

**INDICATOR 5.g:** The GOE enacts a competition law. (A maximum of \$15 million can be disbursed against this indicator.)

#### **Background:**

The importance of this legislation relates to several factors. On the domestic level, the increasing role of the private sector and foreign investment require the existence of a framework to protect consumers and improve the efficiency of the economic sectors through competition. The domestic market has witnessed certain monopolistic practices in some sectors such as the building materials sector, the agriculture products sector and the financial services sector, which need to be addressed. On the international level, the WTO agreement requires the existence of national anti-trust and competition policies. The free trade agreement between Egypt and the EU also includes such a requirement.

The law should provide for an equitable competition regime in which there is a commitment to the removal of as many as possible of the barriers to entry and other bureaucratic barriers. It should provide a clear set of objectives and lay out a suitable framework in which markets can function efficiently and in the public's interest. It should provide for deregulation where appropriate and for a regulatory and arbitration regime that is compatible with available technical and administrative capacity.

#### **Prospects and Issues:**

The GOE is drafting a Competition & Anti-trust law. The draft is being discussed within the Government and will be reviewed by different interested parties in the private sector before final review and approval by the Cabinet. The GOE plans to establish an independent body to be responsible for the enforcement of the law once the People's Assembly enacts it. It is planned that the law and the implementing body will be complemented by other legislation related to privatization, foreign trade policies and consumer protection. The new law will concentrate on the monopolistic behavior of firms. It will also address important issues such as the means of arbitration.

**INDICATOR 5.h**: The GOE issues a decree that removes restrictions on Broker Fees. (Maximum disbursement in support of this indicator is \$5 million.)

#### **Background**

The GOE wishes to increase the volume and liquidity in the market. The GOE previously set maximum charges for some small transactions in the capital market. MOE Decree 1994/478 sets broker fees at a maximum of ½ of one percent for stock transactions of less than LE 10,000 and 1/5 of one percent for all other market transactions less than LE 10,000. This restriction discouraged brokers from engaging in small transactions, thereby limiting the access of small investors to the stock market. It is important that the Egyptian capital market evolve over time to one in which such fees are set competitively and facilitate rather than restrict transactions. The market should develop so that the fees for these transactions are set so as to both cover costs and facilitate transactions. Doing so will contribute to a broader and more effective market. In support of this, the Government plans to issue a decree liberalizing broker fees for small transactions.

#### **Progress to Date**

The Minister of Economy and Foreign Trade has issued a decree that eliminates government restrictions on broker fees. Final disbursement was included in the second disbursement.

**INDICATOR 5.i:** The GOE issues a decree that establishes a code of good practices for bond rating agencies. The maximum disbursement in support of this indicator is \$5 million.

#### **Background**

It was agreed in the amended DSP I Monitoring Plan that a code of good practices and basic requirements for accreditation of bond-rating agencies should be established. The intent is to enhance the transparency and ensure the quality of ratings. Accreditation would ensure the rating agencies operate professionally, independently, and objectively.

Information submitted to rating agencies should be kept confidential. The Capital Market Authority will be the accrediting authority and there should be no conflict of interest on the part of rating agency board members, owners or staff in respect to firms that they rate. Issuers must provide accurate and complete information to the rating agency.

#### **Progress to Date**

The Minister of Economy and Foreign Trade has issued a decree that establishes a code of good practices for bond rating agencies. It includes the elements agreed to in the DSP I Monitoring Plan. Full disbursement under this indicator was included in the second disbursement.

**INDICATOR 6.a:** The GOE issues a decree to advance the development of domestic debt markets. (The maximum disbursement under this indicator is \$25 million.)

#### **Background**

If Egypt is to achieve its ambitious growth targets, it must develop a debt securities market that can efficiently intermediate fixed-rate capital and provide the CBE with the means of conducting indirect monetary policy. T-Bills are currently issued in paper form and can be transferred only by endorsing the certificate. This makes clearing and transfer of secondary trades too expensive and time-consuming to accommodate the volume and speed of trading necessary for indirect monetary policy.

Another important component to enhance the distribution of government securities in the primary market and to stimulate secondary market trading volumes is the establishment of a primary dealer system. Primary dealers are banks and investment dealers authorized to buy and sell government securities in direct dealings with the CBE. Such dealers must be qualified in terms of reputation, capacity and adequacy of capital, staff and facilities. The primary dealer system coupled with an open auction system will provide a fair pricing mechanism by opening the market for investors and supplying a reliable liquidity source.

The Capital Market Development Project is assisting the CBE in the design of procedures that will allow the establishment of a primary dealer system and set the criteria for dealer selection to activate a secondary debt market. The US Treasury is also assisting in this area and is supporting the GOE in the development of the government debt market.

The qualifying events to achieve this indicator are

- A bond dealer decree
- Selection of bond dealers to act as primary dealers for government securities

#### **Progress to Date**

A Ministerial Decree allowing the establishment of dealers for secondary market trading in fixed income securities was issued in January 2000. The Government is proceeding to develop procedures for the selection and regulation of primary dealers. It should be possible to complete this work by the end of DSP I.

**INDICATOR 6.b:** The GOE passes legislation to facilitate the operation of competitive, well-ordered primary and secondary debt markets. (The maximum disbursement under this indicator is \$25 million.)

#### **Background**

An appropriate public debt law and regulations are essential for the development of primary and secondary markets for government debt instruments. The legislation should define responsibilities in debt issuance and trading, and supervisory regulation of these activities. The US Treasury, with USAID financing, is providing assistance to the MOF in drafting a public debt law.

Under the terms of the DSP I agreement, up to \$25 million can be disbursed in support of this indicator on a pro rata basis as a new public debt law receives internal governmental approval and is enacted by the Peoples Assembly.

#### **Progress to Date**

The U.S Treasury with USAID financing assisted in drafting a new debt law. The US Treasury is providing the government with an advisor on debt management. It will probably not be possible to complete the actions necessary for this indicator prior to the end of DSP I. It may be appropriate to include this objective in DSP II.

**INDICATOR 6.c:** The GOE establishes a book-entry registry for government securities. Maximum disbursement in support of this indicator is \$10 million.

#### **Background**

It is important to strengthen the domestic debt market in order to foster stabilization efforts and enhance private investment through facilitating the dematerialization of government debt. This should help increase liquidity in the market, simplify transfer of ownership, ensure safety of transactions, reduce time and expenses of the transfer of ownership of securities, and help encourage portfolio investment through establishing international best practices.

A government debt book-entry system will replace the traditional paper certificate registry of securities ownership with a computerized system that actively maintains the securities outstanding and makes coupon and principal payments. A government securities book-entry system also has the capacity to track transfers of ownership and to facilitate their settlement. Eventually there should be such a system for both government bills and bonds. However, the first phase may be focussed on treasury bills only.

#### **Progress to Date**

The initial steps leading to the establishment of a book entry system have been taken. The Government is now procuring the necessary hardware and the design and purchase of the software is proceeding. The computerized book entry registry for government debt should be in operation by the end of DSP I.

**INDICATOR 6.d:** The government establishes a public debt management unit in the Ministry of Finance. (Maximum disbursement in support of this indicator is \$10 million.)

## **Background**

One of the prime roles of ministries of finance worldwide is the management of the debt, which needs to be issued to fund the government. It is the debt management department, which makes the decisions about how that debt is to be issued.

In a country with emerging bond and money markets, it is essential that sovereign debt issuance be planned in such a manner as to help develop stable and viable primary and

secondary markets in government debt. This is especially important since sovereign debt issuance and trading plays a special role in establishing the viability for all private debt issuance and trading.

The GOE intends to issue a decree to establish MOF/Central Bank recognized Primary Dealers to underwrite and maintain secondary markets in GOE debt. The GOE also plans to introduce and enact a new public debt law to enhance the operation of a competitive, well ordered primary and secondary GOE debt market. To support both these measures, the Ministry of Finance has established a debt management unit and the core staff have been recruited. Full disbursement in support of this indicator was included in the second disbursement.

#### III THIRD DSP I DISBURSEMENT

Under the terms of the DSP I agreement, the first disbursement was for indicators that were completely accomplished, except for the indicators that relate to privatization. For privatization indicators, pro rata disbursements were made in the first disbursement. The first disbursement for DSP I totaled \$ 52.7 million. For subsequent disbursements, pro rata disbursements can be made in support of all indicators where verifiable progress has been made, consistent with the Monitoring Plan. The second disbursement is totaled \$66.6 million. In the table below, those benchmarks are shown for which verification documentation is available and which can be included in the third disbursement.

#### **Indicator**

- 1.a Law 203 Firms
- 1.f Valuation Ins. Cos.
- 1.i Use of Sales Proceeds
- 2 Labor Law
- 3.g Import Sampling Procedures
- 5.a Insurance Industry Reform Plan
- 5.b Egypt Re Reinsurance
- 5.e Mortgage Law

#### **IV. ANNEXES** (See separate volume.)